89-1775

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NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

RICHARD HONGSERMEIER, FIDELA HONGSERMEIER, HOYT W. YOUNG, BARBARA D. YOUNG, ROBERT L. DUFRESNE, CAROLYN S. DUFRESNE, JERRY DIXON, PATRICIA DIXON, RALPH J. RINA, TERRY D. OWENS, AND GLORIA K. OWENS,
Petitioners,

v.

UNITED STATES OF AMERICA, ET AL,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

JOE ALFRED IZEN, JR.
5222 Spruce Street
Bellaire, Texas 77401
(713) 668-8815

Attorney for Petitioners

Alpha Law Brief Co., Inc. — 8748 Westpark — Houston, Texas 77063 — 789-2000

QUESTIONS PRESENTED

(1) Whether complete or substantial compliance with a John Doe summons by the summonsed party divests taxpayers-Petitioners of their right to intervene where their identities were known to the Service prior to issuance of the John Doe summons and prior to such compliance?

(2) Whether Petitioners' Motion for Leave to Intervene should have been granted?

(3) Whether the Internal Revenue Service may utilize a John Doe summons absent proof by the summonsed party that the identities of the taxpayers, concerning whom tax information is sought, are known to the government?

PARTIES

The parties in this case are Petitioners, Richard Hongsermeier, Fidela Hongsermeier, Hoyt W. Young Barbara D. Young, Robert L. DuFresne, Carolyn S. DuFresne, Jerry Dixon, Patricia Dixon, Ralph J. Rina, Terry D. Owens, and Gloria K. Owens.

Respondents are the United States of America and the Internal Revenue Service.

III

ADOPTION OF APPENDIX IN CONSOLIDATED CASE

This Application arises out of three cases which were consolidated on appeal by the Ninth Circuit. It is the companion to the Application for Writ of Certiorari filed concomitantly herewith by Henry F. K. Kersting against the United States of America. Pursuant to the provisions of Rule 30.2 of the Rules of the Supreme Court, Petitioners adopt that Appendix as their own and all references to Appendix documents are to this.

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Petitioners, Richard Hongsermeier, Fidela Hongsermeier, Hoyt W. Young, Barbara D Young, Robert L. DuFresne, Carolyn S. DuFresne, Jerry Dixon, Patricia Dixon, Ralph J. Rina, Terry D. Owens, and Gloria K. Owens, respectfully pray that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Ninth Circuit, which sustained an Order of the United States District Court for the District of

Hawaii denying Petitioners' Motion for Leave to Intervene in a John Doe summons compliance procedure initiated by the Respondent, United States of America, through its agency, the Internal Revenue Service of the United States.

QUESTIONS PRESENTED FOR REVIEW

QUESTION 1

1. Whether complete or substantial compliance with a John Doe summons by the summonsed party divests taxpayers-Petitioners of their right to intervene where their identities were known to the Service prior to issuance of the John Doe summons and prior to such compliance?

QUESTION 2

2. Whether Petitioners' Motion for Leave to Intervene should have been granted?

QUESTION 3

3. Whether the Internal Revenue Service may utilize a John Doe summons absent proof by the summonsed party that the identities of the taxpayers, concerning whom tax information is sought, are known to the government?

REPORTS OF OPINIONS

The Opinion of the Ninth Circuit Court of Appeals in this case was reported at 891 F.2d 1407 and is set forth in Appendix B.

The Order of the United States District Court for the District of Hawaii is not officially reported but a copy of the official decision is set forth in Appendix A.

JURISDICTION

The decision sought to be reviewed here was entered by the United States Court of Appeals for the Ninth Circuit on December 13, 1989. An order denying a Rehearing with Suggestion for Rehearing En Banc was entered by the Court of Appeals on February 16, 1990. That order is set forth in Appendix C.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. Section 1254(1).

STATUTES AND RULES INVOLVED

The following statutes and rules are involved in this case:

26 U.S.C. Section 7602 (Appendix P) and
26 U.S.C. Section 7609 (Appendix R).

RULE 24. INTERVENTION

(a) *Intervention of Right.* Upon timely application anyone shall be permitted to intervene in an action: (1) when a statute of the United States confers an unconditional right to intervene; or (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.

(b) *Permissive Intervention.* Upon timely application anyone may be permitted to intervene in an action: (1) when a statute of the United States confers a conditional right to intervene; or (2) when an applicant's claim or defense and the main action have a question of

law or fact in common. When a party to an action relies for ground of claim or defense upon any statute or executive order administered by a federal or state governmental officer or agency or upon any regulation, order, requirement or agreement issued or made pursuant to the statute or executive order, the officer or agency upon timely application may be permitted to intervene in the action. In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the right of the original parties.

(c) *Procedure.* A person desiring to intervene shall serve a motion to intervene upon the parties as provided in rule 5. The motion shall state the grounds therefor and shall be accompanied by a pleading setting forth the claim or defense for which intervention is sought. The same procedure shall be followed when a statute of the United States gives a right to intervene. When the constitutionality of an act of Congress affecting the public interest is drawn in question in any action to which the United States or an office, agency or employee thereof is not a party, the court shall notify the Attorney General of the United States as provided in Title 28, U.S.C. Section 2403.

Amended effective March 19, 1948; October 20, 1949; July 1, 1963; July 1, 1966; August 1, 1987.

STATEMENT OF THE CASE

Petitioners, Richard Hongsermeier, Fidelia Hongsermeier, Hoyt W. Young, Barbara D. Young, Robert L. DuFresne, Carolyn S. DuFresne, Jerry Dixon, Patricia Dixon, Ralph J. Rina, Terry D. Owens, and Gloria K. Owens, are investors in business transactions structured by Henry Kersting, an alleged "tax shelter promoter."

Petitioners purchased shares in various business corporations utilizing borrowed funds and deducted the interest payments thereon.

Apparently, the Internal Revenue Service began an investigation of Kersting's investment plans in December of 1980. In January of 1981, the Internal Revenue Service obtained and utilized a criminal search warrant to seize various documents from the promoter's (Kersting's) offices in Honolulu, Hawaii. I.R.S. agents and officials conceded, in internal memos, that the search warrant procedure was used to "accelerate" the investigation so that the consequences of the expiration of the three-year statute of limitations could be avoided.

During the search, which took place on January 22, 1981, I.R.S. agents confiscated and carried away ninety-six boxes of documents. Kersting's records were thereafter copied and disseminated to I.R.S. offices throughout the United States. By I.R.S. admission, at least six boxes of documents were turned over to one or more Federal Grand Juries for investigation of possible criminal violations.

Throughout the proceedings below, the Internal Revenue Service has never denied that Petitioners' records were included in those seized on January 22, 1981.

Petitioners received Notices of Deficiency as a result of I.R.S. examinations of Petitioners' tax records seized under the warrant. All of the Petitioners herein named brought actions in the United States Tax Court seeking a redetermination of the tax deficiencies asserted by the I.R.S.

The United States Tax Court, Honorable William A. Goffe, consolidated all of the Petitioners' cases for trial and briefing under the caption, *Dixon, Et Al, v. C.I.R.*, Docket No. 9382-83. As of the date of the filing of this

Petition, the *Dixon* case, which involves the underlying tax merits of Kersting's investment programs, remains pending for decision before the United States Tax Court.

On May 15, 1987, at a time the *Dixon v. C.I.R.* Tax Court case was already pending, the I.R.S. petitioned the United States District Court for the District of Hawaii for leave to serve a John Doe summons on Henry Kersting. In its affidavit, the I.R.S. alleged that Kersting promoted tax shelters of questionable validity and that it sought the summoned documents in order to identify taxpayers participating in his investment program. Neither the I.R.S. nor government counsel made any effort whatsoever to limit the descriptive portion of the John Doe summons so that the names of taxpayers already known to the Service would be deleted.

The John Doe summons purported to relate, on its face, to an investigation of tax years 1984, 1985, and 1986.[1] Yet, the summons directed Kersting to produce all documents relevant to tax years 1981 through 1986.

On August 24, 1987, Henry F. Kersting, the alleged promoter, appeared at a show cause hearing before the Hawaii District Court and contested enforcement of the John Doe summons on various grounds. One of the grounds asserted by Kersting was that I.R.S. issuance of the John Doe summons as to persons whose identities were already known to the Service was an effort by I.R.S. "to subvert" the notice requrements imposed on the government under I.R.C. Section 7609(a).

On January 14, 1988, the District Court ordered enforcement of the John Doe summons over Kersting's objections.

---

1. The records summonsed related to taxable years for which some of your Petitioners have pending Tax Court cases.

Petitioners, who were part of the group of taxpayers "described" in the descriptive portion of the John Doe summons filed a Joint Motion for Leave to Intervene in the John Doe summons enforcement proceedings just prior to the District Court hearing conducted on May 31, 1988. During that hearing, the District Judge held Kersting in contempt and ordered him to produce all of the documents specified in the summons. (See Appendix B, P. 9a) Petitioners' Motion sought both permissive intervention and intervention as a matter of right.

On August 31, 1988, the District Court denied Petitioners' Motion for Leave to Intervene resulting in Petitioners' timely appeal to the Ninth Circuit.

The Ninth Circuit affirmed the District Court's denial of Petitioners' intervention efforts. In its opinion, the Court of Appeals never addressed Petitioners' claims of lack of notice and procedural bad faith, holding, instead, that these issues need not be reached since Kersting's compliance with the John Doe summons, if ". . . substantial . . ." mooted further appellate consideration of the merits of the enforcement. The Ninth Circuit remanded the case to the District Court with instructions ". . . to develop the record further and to decide the motions on their merits should it find that Kersting's opposition to enforcement is not made moot by compliance . . ." (Appendix B, P. 17a.)

Petitioners specifically adopted Henry F. Kersting's Request for Rehearing, which was denied. Petitioners herein join Kersting in petitioning this Court for a Writ of Certiorari to reconcile the conflict which exists between the Federal Courts of Appeals as to whether compliance with a John Doe summons moots any appeal from such enforcement. Petitioners also seek a determination which

will protect Petitioners' rights to avoid I.R.S. utilization of John Doe summons proceedings where the taxpayer's identity is known.

The statutory basis for federal jurisdiction in the United States District Court is 28 U.S.C. Section 1331 and 26 U.S.C. Sections 7602, 7609.

REASON FOR ALLOWANCE OF THE WRIT

1. The decision of the United States Court of Appeals for the Ninth Circuit in *Kersting v. United States*, 891 F.2d 1407 (9th Cir. 1989) directly conflicts with the decision of the United States Court of Appeals for the Third Circuit in *Gluck v. United States*, 771 F.2d 750 (3d Cir., 1985).

Specifically, the Ninth Circuit opinion holds that appeals from summons proceedings after "substantial compliance" are moot while the Third Circuit holds that they are not. (26 U.S.C. Section 7609)

The opinion of the Ninth Circuit in *Kersting* departs from the "accepted and usual course of judicial proceedings" by failing to uphold specific statutory prohibitions on IRS utilization of John Doe summons procedures enacted by Congress in 26 U.S.C. Section 7609(f)(3) requiring the exercise of this Court's supervision. Specifically, the Ninth Circuit's decision allows the IRS to utilize John Doe summons procedures where the identities of taxpayers being investigated are known to the government.

The above specific issues constitute "important questions of federal law which ". . . have not been but should be settled . . ." by this Court.

Further, the Ninth Circuit opinion decides a federal question in a way that conflicts with applicable decisions

of this Court which have consistently upheld statutory limitations on subpoena or summons power promulgated by Congress. *S.E.C. v. Jerry T. O'Brien, Inc.*, 104 S.Ct. 2720 (1984).

ARGUMENT

QUESTION 1

Whether complete or substantial compliance with a John Doe summons by the summonsed party divests taxpayers-Petitioners of their right to intervene where their identities were known to the Service prior to issuance of the John Doe summons and prior to such compliance?

Recognizing a conflict in the Circuits on the issue, the Court of Appeals refused to reach the merits of Petitioners' Motion for Leave to Intervene absent a determination by the District Court that Kersting had "failed to substantially comply" with the John Doe summons enforcement order *prior* to Petitioners' intervention efforts. (Appendix B, Page 10a). In its opinion the Ninth Circuit noted but rejected the reasoning of the Third Circuit in *Gluck v. United States*, 771 F.2d 750, 754 (3d Cir., 1985). (Appendix B, Page 10a, Note 8).

In overruling the I.R.S. argument that compliance with the summons mooted the appeal, the Third Circuit observed—

> "If we find the summonses were illegal, we could still fashion a remedy—prohibition of the use of the summoned documents—to afford the Glucks effective relief."

See *Gluck* at P. 754.

Petitioner Kersting in his related Petition for Writ of Certiorari sets out, at great length, the conflict in the Circuits on the mootness issue. Petitioners adopt Kersting's arguments and further assert that their interest as Intervenors in post-enforcement hearings under Title 26 U.S.C. Section 7609 including contempt proceedings, and any subsequent appeal, is of equal weight and gravity as their position prior to enforcement.

QUESTION 2

Whether Petitioners' Motion for Leave to Intervene should have been granted?

While this Court has previously held in *Hannah v. Larche*, 363 U.S. 420, 80 S.Ct. 1502, 4 L.Ed.2d 1307 (1960) that—

> ". . . Neither the Due Process Clause of the Fifth Amendment nor the Confrontation Clause of the Sixth Amendment is offended when a federal administrative agency, without notifying a person under investigation, uses its subpoena power to gather evidence adverse to him . . ."

specific statutory schemes enacted by Congress *limiting* agency summons or subpoena power have been upheld to the letter.

Prior to the enactment by Congress of the statutory limitations on John Doe summons procedure embodied in Title 26 U.S.C. Section 7609(f)(3) this Court held, in *Reisman v. Caplin*, 375 U.S. 440, 445, 84 S.Ct. 508, 511, 11 L.Ed.2d 459 (1964) that—

> ". . . Both parties summoned [under Section 7602] *and those affected by disclosure may appear or intervene before the District Court and challenge the*

> *summons by asserting their constitutional or other claims."*

See *Reisman* at P. 445.

Later, in *Donaldson v. United States*, 400 U.S. 517, 522, 91 S.Ct. 534, 538, 27 L.Ed.2d 580 (1971) this Court held that the right of a third party to intervene in an enforcement action—

> ". . . Was permissive only and . . . not mandatory. . . ."

See *Donaldson*, 400 U.S. at P. 529, 91 S.Ct., at P. 541.

Third party intervention in summons cases depended upon "the usual process of balancing opposing equities."

Both *Reisman* and *Donaldson* were decided prior to the specific statutory enactment of the limitations on use of John Doe summons procedures found in 26 U.S.C. Section 7609(f)(3).

Petitioners had a specifically defined statutory interest which precluded I.R.S. utilization of John Doe summons proceedings with respect to their tax liabilities. The I.R.S. violated this statutory interest prior to the date of filing of Petitioners' Motion to Intervene. Petitioners thus had a statutorily created interest implicated by the proceedings below and, therefore, had standing to intervene irrespective of whether this Court ultimately determines Petitioners' intervention rights to be mandatory or permissive.

This Court has previously held that the date on which a party seeking intervention became aware of the litigation is, by itself, not always relevant. *N.A.A.C.P. v. New York*, 413 U.S. 345, 366, 93 S.Ct. 2591, 2603, 37 L.Ed.2d 648 (1973). Of more import, in the timeliness context, is the point at which the Intervenor—

". . . Became aware that its interest would no longer be protected adequately by the parties. . . ."

United Airlines, Inc. v. McDonald, 432 U.S. 385, 394, 97 S.Ct. 2464, 2469, 53 L.Ed.2d 423 (1977).

Under the facts of this case, Petitioners sought to intervene at the point that Kersting was held in contempt and faced severe fines in the event Petitoners' records were not turned over. It was, at this point, that Kersting's representation of Petitioners' interests became ". . . inadequate. . . ." *Legal Aid Society of Alameda County v. Dunlap,* 618 S.2d 48 (9th Cir., 1980) at P. 50.

The burden imposed on a prospective intervenor to show that the representation of his interest "may be" inadequate is minimal under the rule. *Trbovitch v. U.M.W.,* 404 U.S. 528, 538-39 at note 10, 92 S.Ct. 630, 636, note 10, 30 L.Ed.2d 686 (1972).

Intervention should be allowed even after final judgment where it is necessary to preserve some right which can not otherwise be protected. *Pellegrino v. Nesbit,* 203 F.2d 463 (9th Cir., 1953) at PP. 465 and 466.

Any doubts about the adequacy of representation should be resolved in favor of granting leave to intervene. *Trbovitch* at P. 636. 3 B. J. Moore, *Federal Practice,* Section 24.09-1[4] (1969).

Over thirty years ago, the former Chief Justice of this Court had occasion to consider efforts to intervene in a proceeding brought under a federal immunity statute. Title 18 U.S.C. Section 3486(a and b). The District Court denied intervention on the ground that the prospective witnesses who would be forced to give up their Fifth Amendment rights against self-incrimination in exchange

for immunity from prosecution had "no justiciable interest." Justice Warren E. Burger, in a concurring opinion reversing the denial of intervention status stated—

> "We go beyond the companion opinion and hold that the witness should be *given reasonable notice of the application*, be allowed to appear in the proceeding and be heard on the following: (1) whether the committee was a committee of the current session of Congress purporting to exercise powers duly conferred upon it; (2) whether the witness recently and at least during the current session of Congress declined on the grounds of the privilege against self-incrimination, to answer questions asserted by said committee to be within the scope of Title 18, Section 3486(a); (3) whether the Attorney General of the United States was given notice pursuant to the statute; (4) whether the committee by the prescribed two-thirds vote authorized the application to the District Court for a grant of immunity to the witness after having claimed his privilege; (5) whether the application is made to the District Court for the district wherein such inquiry of the committee is being conducted.
>
> *The discretion of the District Court is limited at this stage to a determination of the procedural irregularity* of an application and does not embrace such issues as the scope of the inquiry, the pertinency and relevancy of the questions propounded or the constitutionality of the statute."

In Re: McElrath, 248 F.2d 612, 617 (D.C. Cir. 1957).

While *McElrath* was decided en banc with a concurring opinion, all nine Justices agreed that intervention was mandatory. As noted in Justice Edgerton's opinion—

> "The Court erred also in not allowing Appellants to intervene as Defendants. Orders against them were sought and obtained. *If they had been valid, these orders might have compelled them to make disclosures that would have injured their reputations and so their economic and social interest. The law does not ignore such injuries.* Appellants were squarely within Rule 24(a) of the Federal Rules of Civil Procedure: Intervention of Right. Upon timely application anyone shall be permitted to intervene in an action: . . . when their representation of the Applicant's interest by existing parties is or *may be inadequate and the Applicant is or may be bound by a judgment in the action. . . .*"

The D.C. Circuit went on to rule that the Motion for Leave to Intervene should have been granted "notwithstanding a holding that this particular proceeding was prematurely instituted." *McElrath* at P. 616.

The Court of Appeals' rationale in *McElrath* answers not only the merits of Petitioners' Motion for Leave to Intervene but, also, addresses and rejects the mootness arguments advanced by the District Court and the Court of Appeals. *McElrath* inferentially aligns the District of Columbia Circuit with the Third Circuit's rationale expressed in *Gluck* supra.

Since the *procedural irregularity* of I.R.S. use of John Doe summons procedures was squarely at issue and remained so throughout the pre-enforcement and post-enforcement summons proceedings, Petitioners should have been granted leave to intervene. The failure to grant such leave was error and should be reversed.

QUESTION 3

Whether the Internal Revenue Service may utilize a John Doe summons absent proof by the summonsed party that the identity of the taxpayers, concerning whom tax information is sought, are known to the government?

In *S.E.C. v. Jerry T. O'Brien, Inc.*, 104 S.Ct. 2720 (1984) this Court, refused to uphold a "notice requirement" imposed on the S.E.C. by the Ninth Circuit. This Court, acting under its supervisory powers, refused to impose a requirement that the S.E.C. notify a third party upon the issuance of a subpoena seeking information concerning his interest.

This Court, through Justice Marshall, laboriously examined Congress' statutory scheme which "balanced" the interest of governmental enforcement against personal right to privacy and non-disclosure. In so doing, Justice Marshall, and the unanimous members of this Court noted—

> "It appears, in short, that Congress intended to vest the S.E.C. with considerable discretion in determining when and how to investigate possible violations of the statutes administered by the Commission. *We discern no evidence that Congress wished or expected that the Commission would adopt any particular procedures for notifying 'targets' of investigations when it sought information from third parties.*
>
> The inference that the relief sought by Respondents is not necessary to give effect to Congressional intent is reinforced by the fact that, in one special context, Congress has imposed on the Commission

> an obligation to notify persons directly affected by its subpoenas.

O'Brien, 104 S.Ct. 2720, 2726, 2727.

Here, the exact opposite holds true. Congress has specifically refused to allow I.R.S. to utilize John Doe summons procedures when the identity of a taxpayer *is known*. In promulgating the limitations on John Doe summons enforcement power embodied in Title 26 U.S.C. Section 7609(f)(3), Congress created a "taxpayer's right," which the District Court and the Court of Appeals completely ignored.

The inquiry of this Court should be whether the actions of the District Court and the Court of Appeals are—

> ". . . Consistent with the underlying purposes of the legislative scheme. . . ."

S.E.C. v. Jerry T. O'Brien, Inc, 467 U.S. 735, at 104 S.Ct. 2720, 2727, 2728, note 17.

Under Justice Marshall's analysis the intent of Congress that John Doe summons procedures *not* be used against known taxpayers supports a finding of procedural irregularity in the issuance of the John Doe summons which is analogous to bad faith and abuse of Court process. *United States v. Powell*, 379 U.S. 48, 85 S.Ct. 248, 13 L.Ed.2d 112 (1964). The intent of Congress should be upheld and the District Court's Order enforcing the John Doe summons should be reversed.

This Court has recently held that a Petitioner denied notice of due process should be—

> ". . . Restored . . . to the position he would have occupied had due process of the law been accorded him in the first place. . . ."

Peralta v. Heights Medical Center, Inc., 108 S.Ct. 896 (1988). As noted there by Justice White—

> "The Due Process Clause demands no less."

CONCLUSION

In an era of diminishing civil and personal rights, Petitioners do not expect this Court's decision to stem the flood of decline. To uphold the actions of the District Court and the Court of Appeals would be to "pull the finger from the dike."

The District Court's order denying Petitioners' Motion for Leave to Intervene should be reversed. The District Court's order enforcing the John Doe summons should be reversed and this Court should render judgment directing that Respondents return all of Petitioners' documents produced under the District Court's enforcement order and that no further use of same be made by Respondents. In the alternative to a rendition at this level the case should be remanded with instructions.

Respectfully submitted,

JOE ALFRED IZEN, JR.
5222 Spruce Street
Bellaire, Texas 77401
(713) 668-8815

Attorney for Petitioners

(2) (2)

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v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

GARY R. ALLEN
CHARLES E. BROOKHART
WILLIAM A. WHITLEDGE
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 514-2217

QUESTIONS PRESENTED

1. Whether the district court erred in enforcing a summons requiring a tax shelter promoter to identify his customers for 1984-1986 and to provide other information that would assist the government in conducting audits of their income tax returns for those years.

2. Whether the district court had jurisdiction to entertain a motion to intervene in a summons enforcement proceeding after the court had ordered the summons enforced and an appeal had been taken to the court of appeals from that order.

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-17a)[1] is reported at 891 F.2d 1407. The order of the district court enforcing the summons (Pet. App. 35a-38a) is unreported. The order of the district court denying intervention, an evidentiary hearing, and

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[1] "Pet. App." refers to the appendix to the petition in No. 89-1774.

assessment of costs (Pet. App. 21a-25a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 13, 1989. A petition for rehearing was denied on February 16, 1990 (Pet. App. 1a-2a). The petitions for a writ of certiorari were filed on May 16, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Kersting has a history of promoting tax shelters of questionable validity.[2] The Commissioner of Internal Revenue has previously disallowed deductions claimed by participants in Kersting's shelters, and there are currently more than 1300 docketed Tax Court cases involving more than 600 investors in Kersting's shelters for taxable years prior to 1982. The IRS learned the names of those 600 individuals from documents that were seized from Kersting's offices pursuant to a search warrant in January 1981. Pet. App. 5a-6a & n.4, 56a; Pet. 21.

The Internal Revenue Service (IRS) is currently conducting an investigation to learn the identities of

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[2] Those shelters purport to generate substantial interest deductions for the participants when, in fact, the transactions that supposedly create the interest payments are circular loans or check swaps between 34 related entities that merely give the appearance that funds are transferred from one to another (Pet. App. 55a-56a). In a case involving one of Kersting's investors, the Tax Court held that the deductions generated by the transactions in Kersting's shelter program were not allowable because they did not create any true indebtedness, and no interest was actually paid. *Pike* v. *Commissioner*, 78 T.C. 822 (1982).

the participants in Kersting's shelter programs during the 1984-1986 period and to obtain information that will aid in auditing their income tax returns for those years. The IRS issued a "John Doe" summons (see 26 U.S.C. 7609) to Kersting requiring the production of all customer lists identifying the participants from 1984-1986 in any tax shelter plan promoted by him, any documents relating to those participants during those years, the books and records for the 34 corporations utilized by Kersting in the shelter promotions for 1981-1986, and bank and other records for those entities for 1984-1986 (Pet. App. 5a & n.2; see *id.* at 41a-45a, 58a-59a).

Section 7609(f) of the Internal Revenue Code (26 U.S.C.) requires the IRS to obtain authorization from a federal district court before serving a John Doe summons. The government must demonstrate to the court that the summons relates to an investigation of an ascertainable class of persons, that there is a reasonable basis for believing that the persons in that class may have failed to comply with the provisions of the Internal Revenue Code, and that the information sought is not readily available from other sources. The IRS made the necessary showing to the United States District Court for the District of Hawaii, and the district court issued an order authorizing service of the summons and also directing Kersting, if he objected to compliance, to appear before the court and show cause why the summons should not be enforced (Pet. App. 63a-70a).

Kersting objected to the summons, asserting that the summons was "issued as part of [an] on-going campaign of administrative bad faith on the part of the Commissioner" (No. 88-1738 C.R. E, Objections

to Summons 2).[3] The objections were supported by an affidavit filed by Kersting in which he stated that he was "firmly convinced that the above-referenced Summons is purely a continuation of the bad-faith campaign of persecution waged against him by the Internal Revenue Service since at least December of 1980" (No. 88-1738 C.R. E, Affidavit ¶ 4), noting that his offices had been searched and that he was aware of two grand jury investigations of his activities (*id.* ¶¶ 6, 13).

Following a hearing, the district court ordered the summons enforced (Pet. App. 35a-38a). The court found that the government had made the *prima facie* showing required for enforcement by *United States* v. *Powell*, 379 U.S. 48 (1964), and that Kersting had failed to rebut that showing. Specifically, the court found that the investigation had the legitimate purpose of investigating possible tax violations by Kersting's clients; that the requested documents met the standard for relevance; that the government did not already know the identities of all of Kersting's clients; and that there was no evidence that any persons who were the subject of the summons were currently subject to a referral to the Justice Department for criminal prosecution (Pet. App. 36a-38a; see also *id.* at 7a).[4]

2. In February 1988, Kersting filed a notice of appeal and a motion for a stay pending appeal (Pet. App. 7a & n.6). Both the district court (*id.* at 30a-34a) and the court of appeals (*id.* at 26a) denied the

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[3] "C.R." refers to documents contained in the excerpts of record on appeal.

[4] The court added that, if Kersting could show that there was such a referral, he did not have to provide information regarding the persons covered by the referral (Pet. App. 38a).

request for a stay. Subsequently, on May 31, 1988, the district court orally held Kersting in contempt for failure to comply with the summons (*id.* at 8a) and warned him that he would be fined $1,000 per day if he failed to produce the records as ordered (Nos. 88-15549 and 88-15565 C.R. Y, May 31, 1988 Tr. 26; see Pet. 8). Kersting thereafter produced some of the summoned records and moved for discharge from prior orders of the district court, claiming that he had substantially complied with the summons; the government in turn claimed that Kersting had not fully complied (Pet. App. 8a). The district court refused to consider the merits of this motion, finding that it did not have jurisdiction over the matter while Kersting's appeal from the enforcement order was pending (*ibid.*). No written order holding Kersting in contempt was ever entered, and no further proceedings were held on the government's motion to have Kersting held in contempt.

3. At the May 31, 1988, hearing, petitioners in No. 89-1775—11 individuals who had invested in Kersting's programs prior to 1982 and are among those investors currently engaged in litigation in the Tax Court (see p. 2, *supra*)—moved to intervene in the summons enforcement proceeding. The district court denied the motion because a notice of appeal had already been filed from the enforcement order, explaining that "there is no longer any proceeding in which to participate" and that the "court no longer has any jurisdiction" to consider the motion (Pet. App. 24a). The court also denied for the same reason several other motions made by Kersting at that time, which pertained to discovery and the recovery of costs of complying with the summons. *Id.* at 21a-25a; see also *id.* at 8a-9a.

4. The court of appeals consolidated all of the appeals from the district court—Kersting's appeals from the enforcement order and from the district court's refusal to consider his post-appeal motions and the appeal of petitioners in No. 89-1775 from the denial of their motion to intervene. The court of appeals affirmed the order enforcing the summons (Pet. App. 11a-15a), holding that the government had made a sufficient *prima facie* case to warrant enforcement of the summons and that Kersting had failed to rebut that showing. In particular, the court concluded that the district court had not been clearly erroneous in finding that all of the summoned documents were relevant to the investigation (*id.* at 12a-14a), and it found that "[t]he summons had a legitimate purpose: to find out who had been investing in Kersting's schemes" (*id.* at 14a). The court of appeals also affirmed the district court's holding that it lacked jurisdiction to consider the investors' motion to intervene and the motions filed by Kersting after he had filed a notice of appeal from the enforcement order, finding that these matters were not collateral to the subject of the appeal (*id.* at 15a-17a).[5]

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[5] The court of appeals also noted that Kersting's appeal of the enforcement order would be moot if he had substantially complied with the order, but the court concluded that the record was inadequate for it to determine whether there had been compliance (Pet. App. 10a-11a). The court of appeals directed the district court to determine on remand whether Kersting had substantially complied and, if it determined that a live controversy remains, to consider the merits of the motions previously denied by the district court for lack of jurisdiction (*id.* at 11a, 17a).

ARGUMENT

1. Petitioners' primary contention (89-1774 Pet. 10-15; 89-1775 Pet. 9-10) is that this Court should grant certiorari to decide whether compliance with a summons moots an appeal from an order enforcing that summons. That question is not presented here. The court of appeals did state its view that compliance with a summons would moot an appeal from an enforcement order,[6] but that statement did not form the basis for its decision. Rather, the court of appeals ruled that it could not determine on the present record whether Kersting had complied with the summons, and therefore it proceeded to consider the enforcement order on the merits, ruling that it should be affirmed and the case remanded to the district court for further proceedings. Thus, the court of appeals did not find that any of the appeals in this case was moot, and it would afford no relief to any of the petitioners if this Court were to state that compliance with a summons does not moot an appeal from an enforcement order. Petitioners are simply seeking an advisory opinion on a question that is not before this Court.

2. The issue that is properly presented here by petitioner Kersting is his claim (Pet. 15-23) that the summons should not have been enforced because it was not issued in good faith. This contention is entirely factbound and was correctly rejected by both courts below. There is no reason for further review by this Court.

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[6] This statement accords with the law previously established in the Ninth Circuit and in every other circuit that has considered the question, except for the Third Circuit. See Pet. App. 10a n.8.

Petitioner Kersting's allegations do not demonstrate any impropriety by the IRS in the conduct of its investigation or the issuance of the summons. Kersting argues (Pet. 15-16, 19-22; see also 89-1775 Pet. 15-17) that the IRS acted in bad faith because the stated reason for issuing the summons was to obtain the names of Kersting's clients during the 1984-1986 period when the IRS already knew the names of more than 600 Kersting clients who were currently litigating in the Tax Court the validity of deductions claimed for investments in tax shelters promoted by Kersting prior to January 1981. There was, however, no reason to believe that the same individuals who had invested in Kersting's schemes before January 1981 comprised his investors in 1984, 1985, and 1986. As the court of appeals stated (Pet. App. 14a), Kersting's "contention is equivalent to Kersting saying that the IRS must take his word for what is in his records, which, of course, it is not required to do." [7]

Petitioner Kersting also contends (Pet. 15, 22-23) that the summons was invalid under Section 7602(c) of the Code because Kersting and, allegedly, some of his investors were subjects of a grand jury investi-

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[7] Petitioner Kersting also asserts (Pet. 15, 22) that the IRS sought "to avoid the notice requirements of Section 7609(a)" of the Code. This assertion is entirely without foundation. Section 7609(a) imposes certain notice requirements upon the IRS when it issues a summons to certain specifically defined "third-party recordkeeper[s]," such as banks, attorneys, accountants, etc.; that provision clearly does not include tax shelter promoters such as Kersting. The IRS was not required to give notice to anyone before issuing a summons for Kersting's records, and there is no basis for suggesting that the use of a "John Doe" summons here was intended to avoid some notice requirement or was improper in any other way.

~~gation in 1982 and 1983. Section 7602(c) provides~~

gation in 1982 and 1983. Section 7602(c) provides that no summons shall be issued with respect to a person if a Justice Department referral, which includes a recommendation for a grand jury investigation, is in effect with respect to that person. Although Kersting himself was informed that he would not be prosecuted, and therefore he concededly was no longer subject to a referral within the meaning of Section 7602(c), he alleges that there may remain outstanding Department of Justice referrals with respect to the other unnamed investor/targets. This objection to the summons in this case is without merit. First, Section 7602(c)(3) explicitly states that for purposes of that section each taxable year "shall be treated separately." Accordingly, even if there were outstanding referrals relating to grand jury investigations for pre-1982 years, that would not defeat this summons, which was inquiring into tax liabilities for 1984-1986. Moreover, the government represented to the district court that the grand jury investigations had terminated and that there was no ongoing grand jury investigation with respect to any of the investors. See No. 88-1738 C.R. I, Aug. 24, 1987 Tr. 14-15. And, finally, the district court's enforcement order specified that Kersting was not required to produce records with respect to any investor who he could demonstrate was under grand jury investigation (Pet. App. 37a-38a).

In sum, the district court correctly held that petitioner Kersting had not made a sufficient showing to justify either an evidentiary hearing or a refusal to enforce the summons. There is no reason for this Court to review the court of appeals' affirmance of that conclusion (see Pet. App. 15a).

3. Petitioners in No. 89-1775 contend (Pet. 10-14) that the district court should have granted their motion to intervene. But petitioners' argument is de-

voted to the merits of their intervention motion, a matter that was not considered by either of the courts below. Rather, the district court rejected the intervention request because the prior filing of a notice of appeal had divested it of jurisdiction over the summons enforcement action (Pet. App. 24a), and the court of appeals affirmed on this ground (*id.* at 16a). Petitioners advance no authority or argument to suggest that this jurisdictional ruling was erroneous. Accordingly, they present no basis for disturbing the judgment below; their contentions on the merits of the intervention question are not properly presented.[8]

Similarly, there is no basis for this Court to review the merits of petitioner Kersting's various motions that were denied by the district court for lack of jurisdiction. In particular, Kersting's arguments on the merits of its motion to recover in advance the costs of complying with the summons (Pet. 25-27) were not considered by either court below and are not properly presented here.[9]

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[8] Indeed, the court of appeals directed the district court on remand to consider the merits of the intervention motion, in the event the court determines that the case is not moot (Pet. App. 17a).

[9] Petitioner Kersting's arguments for recovery of costs are, in any event, without merit. Section 7610 of the Code provides that a summoned person may be reimbursed for "reasonably necessary" costs incurred directly in searching for and reproducing the summoned data; 26 C.F.R. 301.7610-1 establishes rates of reimbursement and also provides that no payment will be made until full compliance with the summons has been accomplished and the summoned party has submitted an itemized bill to the IRS. The courts have consistently rejected the contention that an unconstitutional taking occurs when the reimbursement provided by statute fails to cover

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

SHIRLEY D. PETERSON
Assistant Attorney General

GARY R. ALLEN
CHARLES E. BROOKHART
WILLIAM A. WHITLEDGE
Attorneys

AUGUST 1990

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completely the costs of compliance incurred by a subpoenaed or summoned party. See, *e.g.*, *United States* v. *Continental Bank & Trust Co.*, 503 F.2d 45 (10th Cir. 1974); *United States* v. *Dauphin Deposit Trust Co.*, 385 F.2d 129, 130 (3d Cir. 1967), cert. denied, 390 U.S. 921 (1968). And the courts have also consistently recognized that advance reimbursement is not a precondition to enforcement of a summons. See, *e.g.*, *In re Tax Liabilities of: John Does, All Unknown Employees of Boundary Waters Restaurant*, 866 F.2d 1015, 1022 (8th Cir. 1989); *United States* v. *Schmidt*, 816 F.2d 1477, 1482-1483 (10th Cir. 1987); *United States* v. *Money*, 744 F.2d 779, 780 (11th Cir. 1984). Thus, Kersting's contention that he is entitled to an award of costs in excess of that allowed by Section 7610 is, at best, premature.

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NO. 89-1775

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

RICHARD HONGSERMEIER, FIDELA HONGSERMEIER, HOYT W. YOUNG, BARBARA D. YOUNG, ROBERT L. DUFRESNE, CAROLYN S. DUFRESNE, JERRY DIXON, PATRICIA DIXON, RALPH J. RINA, TERRY D. OWENS, AND GLORIA K. OWENS,
Petitioners,

v.

UNITED STATES OF AMERICA, ET AL,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONERS

JOE ALFRED IZEN, JR.
5222 Spruce Street
Bellaire, Texas 77401
(713) 668-8815
Attorney for Petitioners

Alpha Law Brief Co., Inc. — 8748 Westpark — Houston, Texas 77063 — 789-2000

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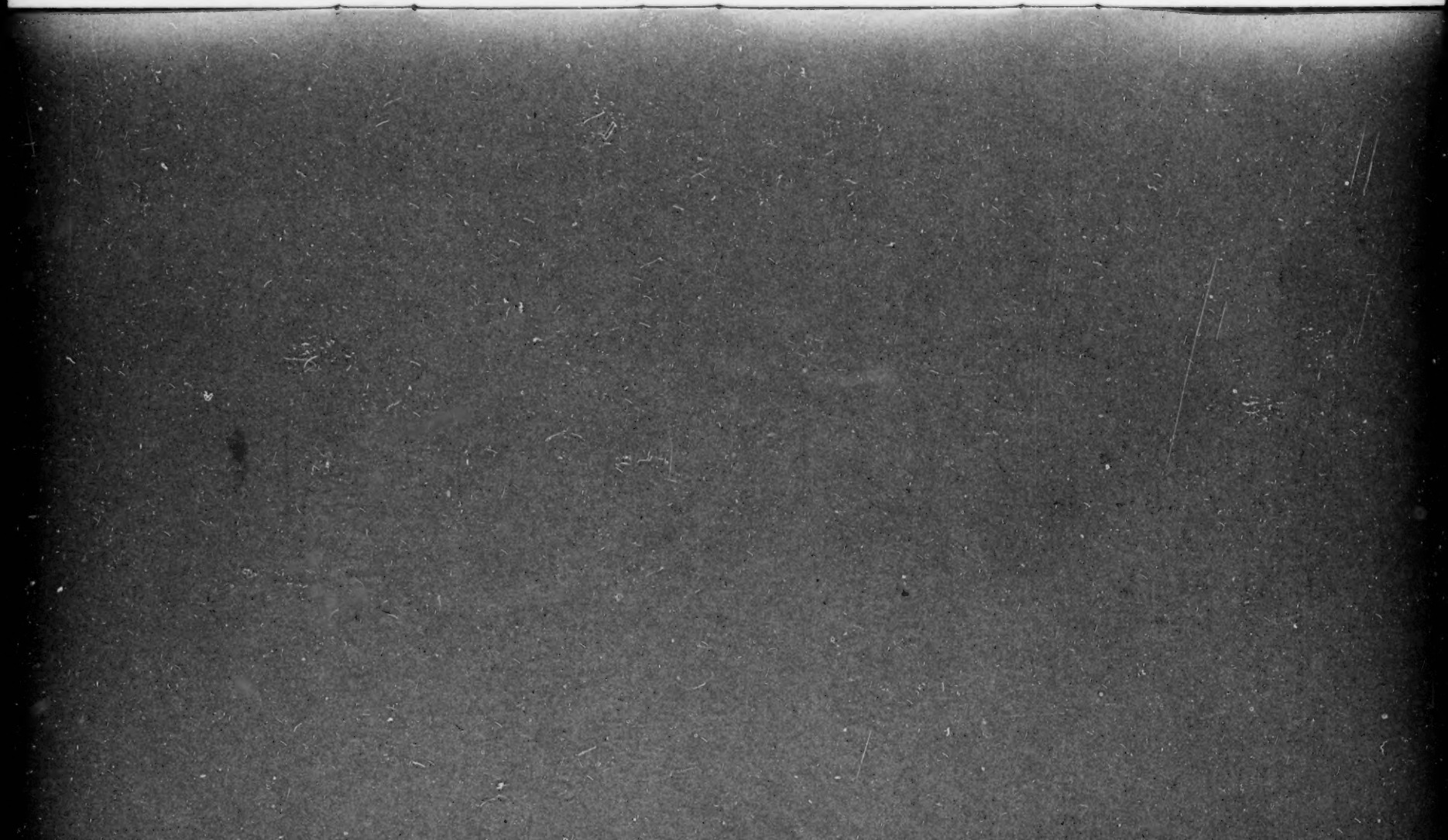

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REPLY BRIEF FOR PETITIONERS

To The Honorable Justices Of This Honorable Court:

Petitioners, Richard Hongersmeier, Fidela Hongsermeier, Hoyt W. Young, Barbara D. Young, Robert L. Dufresne, Carolyn S. Dufresne, Jerry Dixon, Patricia Dixon, Ralph J. Rina, Terry D. Owens, and Gloria K.

Owens (collectively "Intervenors"), submit this reply brief in response to the Brief in Opposition ("OPB. ____") filed herein by the United States of America ("Respondents" or "I.R.S.") on August 13, 1990. Petitioners incorporate by reference herein their Opening Petition and also reference, and join in the Opening and Reply Brief filed in No. 89-1775 by Petitioner Henry F.K. Kersting ("Petitioner").

STATEMENT

This case involves the issuance of a John Doe summons to Petitioner Kersting, for the records of investors in the so-called "Kersting companies," when the I.R.S. was aware of the identity of hundreds of persons whose records were summoned by the John Doe summons, including those of Intervenors, and was in possession of many of the documents summoned. The Government even continues its attacks on Petitioner Kersting, by attempting to smear him as a "promoter of tax shelters of questionable validity." Petitioners succinctly distinguish the Government's misrecital of *Pike v. Commissioner,* 78 T.C. 822 (1982).[1]

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1. *Pike* involved deductions for Sub-chapter S car leasing companies which were disallowed because the Tax Court found that there was no hope of making a profit because the car rentals were too low. It had nothing to do with the current companies with which Petitioner, Kersting is involved or was involved during the times relevant to the John Doe summons at issue in this case. The Government has attacked what it claims are "circular payments or exchanges of checks" and has further attacked the validity of the notes involved in financing the stock transactions in question (all the while acting through its agents to actively impede collection suits filed by the corporations in state courts). Indeed, the mere proof of circular payments or exchange of checks does not prove a sham and substantial economic interest may be involved, despite such check exchanges, which ultimately create bona fide indebtedness and result in substantial economic exchange of consideration. *United States v. Kilpatrick,* 726 F.Supp. 789 (D.C. Colo., 1989).

The Government next attempts to dismiss Petitioners' arguments in simplistic, albeit erroneous fashion.[2]

Despite their claims, Respondents essentially admit that the District Court should grant intervention, but only when they find jurisdiction to hear the claims raised following determination of the mootness issue after substantial compliance.

Despite its claim that Intervenors advance no argument to show the erroneous jurisdictional argument supported by the District Court and Appeals Court order, the Government fails even to address Intervenors' authorities supporting intervention. Respondents slyly back away from consideration of the law in *Gluck, supra.* Clearly if the Court followed *Gluck,* Intervenors could intervene in the summons enforcement action and participate in the hearings as they requested below.

Admittedly, the Government prevailed on the initial issue concerning administrative bad faith—the purpose of the investigation itself. The District Court, however, ignored procedure tainted by the Government's deliberate concealment of the known identities of 600 investors as well as its possession of literally hundreds of thousands of documents that responded to the John Doe summons. These facts fully reflect the Government's administrative

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2. Respondents oppose intervention because: (a) the District Court rejected intervention in the summons enforcement action below because the prior Notice of Appeal divested the court of jurisdiction, which the court of appeals affirmed on the same ground. OPB. 9-10; (b) Intervenors advance no authority or argument that suggest that this jurisdictional ruling was erroneous; and (c) No basis to disturb judgment below exists, and the merits of the intervention question is left to the district court on remand based on a determination that the case is not moot. *Id.;* 10 n.8.

bad faith in bringing the summons proceeding in the first instance, its "good faith affidavit" notwithstanding.

Only now does the Government admit the facts concealed from the lower courts. While they admit that the 600 investors discovered with the January 22, 1981 search warrant were then in Tax Court on some of the years in question in the summons, OPB. 2, the Government conveniently overlooks the fact that Intervenors were all parties in those same 1300 cases pending in the Tax Court litigation (*Dixon, et al v. Commissioner,* Docket No. 8392-83). The Government also neglects the "dragnet provisions" of the John Doe summons which had the effect of "capturing" documents going back to the first of January, 1981. If the I.R.S. was only interested in the investors in 1984-1986, why did it have to go back three more years and then conceal the documents which it already had in its possession?

This Court should note that the ultimate issues in *Dixon* involve the bona fides of the deductions generated through investments in the "Kersting companies." The same parties in this case litigated the issues in Dixon, as "Test Case petitioners," at the same time that the I.R.S. requested the John Doe summons for an allegedly separate investigation of the same or similar deductions.

In its Brief in Opposition, the Government blithely ignores the main issue on which Intervenors appealed—the Government's use of a John Doe summons when the identities of those whose records were sought were known to the Government and when many of the documents sought were already in the Government's possession. This all the while now admitting that the identities of 600 investors were known to the Government before the

summons was sought! This judicial admission of administrative bad faith was either blindly ignored by the District Court in its rush to compel Kersting to produce documents or concealed by the Government from the District Court in order to prevent it from reaching the proper conclusion on the Government's "good faith" in bringing the summons proceeding. As to the Intervenors, the Government admits that they "are among those investors currently engaged in litigation in Tax Court." (Brief in Opposition, page 5) Obviously, then the identities of these Intervenors and their participation in the "Kersting programs" was and is known to the Government because it is a matter of public record in the United States Tax Court—proceedings to which the Commissioner of Internal Revenue is a party.

The Government next makes an inconsistent argument. It claims the Court of Appeals for the Ninth Circuit affirmed on the ground (against the Intervenors) of lack of jurisdiction yet quotes early in its brief language of the Ninth Circuit which states that if Kersting has not substantially complied then the District Court is to take jurisdiction of the case and determine Intervenors' motions and grant Intervenors status to intervene.

The Government gravely misstates the holding of the Court of Appeals on the Motion to Intervene. Intervenors understanding of the Court of Appeals' ruling on the intervention was that it considered the claims of the Intervenors and noted that it was refusing to act because Kersting's turnover of his records "mooted" the controversy and that if the Government sought to use the records *then* the Intervenors could attack the constitutionality and legal propriety of the Government's use of

the John Doe summons procedure where the Intervenors' identities were known.

The Government's footnote #5 is inconsistent with its argument of lack of jurisdiction. The Government claims—

> "The Court of Appeals directed the District Court to determine on remand whether Kersting had substantially complied and, if it determined that a live controversy remains, to consider the merits of the motions previously denied by the District Court for lack of jurisdiction."
>
> See Brief in Opposition, Page 6, Note 5.

In essence, the Intervenors who were "locked out of the case" are now in the case if, as the Government claims, Kersting has not substantially complied with the summons enforcement order. Therefore, it would seem the Intervenors substantially prevailed on their appeal and were not "ruled against" by the Court of Appeals.

ARGUMENT

QUESTION I

THIS COURT SHOULD GRANT CERTIORARI TO DETERMINE WHETHER INTERVENORS MOTION TO INTERVENE SHOULD HAVE BEEN GRANTED.

Petitioner Kersting, in his related Petition for Writ of Certiorari and in his Reply Brief, sets out, at great length, the conflict in the Circuits on the mootness issue. Intervenors adopt Kersting's arguments and further assert that their interest as Intervenors in post-enforcement hearings under Title 26 U.S.C. Section 7609, including con-

tempt proceedings, and any subsequent appeal, is of equal weight and gravity as their position prior to enforcement.

A John Doe summons is a direction to a third-party to surrender information concerning taxpayers *whose identity is unknown* to the I.R.S. *See In Re Tax Liabilities of John Does,* 671 F.2d 977, 978 (6th Cir. 1982).[3]

> "Section 7609(f)'s criteria thus constitute a procedural safeguard which Congress created to provide extra protection to unknown target taxpayers to whom the I.R.S. cannot give notice."

United States v. Samuels, Kramer & Co., 712 F.2d 1342, 1346 (9th Cir. 1983), citing *United States v. Pittsburgh Trade Exchange, Inc.,* 644 F.2d 302, 305 (3rd Cir. 1981).

Intervenors had a specifically defined statutory interest which precluded I.R.S. utilization of John Doe summons proceedings with respect to their tax liabilities connected in any way to the "Kersting companies." The I.R.S. violated this statutory interest prior to the date of filing of Intervenors' Motion to Intervene. Intervenors thus had a statutorily created interest implicated by the proceedings below and, therefore, had standing to intervene irrespective of whether this Court ultimately determines Intervenors' intervention rights to be mandatory or permissive.

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3. Title 26 U.S.C. Sec. 7609 provides that the I.R.S. may serve such a summons only if it can establish in a court proceeding (1) that the summons relates to the investigation of a particular person or an ascertainable group or class; (2) that there is a reasonable basis for believing that such person or group or class of persons may fail or have failed to comply with any provision of any internal revenue law, and (3) the information sought to be obtained from the examination of records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

Intervenors sought to assert this right to intervene before documents and information had been supplied by Kersting to the I.R.S. in response to the John Doe summons. Intervention was sought when Kersting was held in contempt and faced severe fines in the event Intervenors' records were not turned over. It was at this point that Kersting's representation of Intervenors' interests became ". . . inadequate. . . ." *Legal Aid Society of Alameda County v. Dunlap,* 618 P.2d 48 (9th Cir. 1980) at p. 50.

The compelling logic and rationale of *In Re: McElrath,* 248 F.2d 612 (D.C. Cir. 1957) addresses and rejects the mootness arguments advanced by the District Court, the Court of Appeals and the Government in its Brief in Opposition.

Even if this Court holds that this case would otherwise be moot, applying the "capable of repetition yet evading review" exception to the mootness doctrine recognized by this Court in *Southern Pacific Terminal Co. v. ICC,* 219 U.S. 498, 515 (1911), this Court should grant review because the latter prong of the exception—that the controversy be sufficiently likely to be repeated—has been met herein in light of the history of dealings between the parties and the increasing use of the John Doe summons by the I.R.S.

Since the *procedural irregularity* of I.R.S. use of John Doe summons procedures was squarely at issue and remained so throughout the pre-enforcement and post-enforcement summons proceedings, Intervenors should have been granted leave to intervene. The failure to grant such leave was error and should be reversed.

CONCLUSION

For the foregoing reasons, the petitions should be granted and a writ of certiorari should be issued to review the decision below.

Respectfully submitted,

JOE ALFRED IZEN, JR.
5222 Spruce Street
Bellaire, Texas 77401
(713) 668-8815

Counsel of Record for Intervenors Richard Hongersmeier, et al

September, 1990